MAY 31 1950
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 98

REPUBLIC STEEL CORPORATION,
Petitioner,

vs.

THE UNITED STATES OF AMERICA,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF

LUTHER DAY,
THOMAS F. PATTON AND
EARL W. LEFEVER,
Counsel for Petitioner.

INDEX

	Page
PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS	1
Opinion Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Summary and Short Statement of the Matter Involved	3
Reasons Relied upon for Allowance of Writ	6
BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI	9
Specification of Errors to be Urged	9
Summary of Argument	10
I	10
II	10
III	11
Argument	11
I. The preferred shareholders' interest in the transferred property immediate after the transfer is not determined by the preferred shares' then market value	11
A. Such interest of the preferred shareholders was limited by provisions of the corporate articles to $75.00 per share or a total of $8,775,000, which is less than 50%	11
B. Such shares' value of $10,228,846.15 included $1,453,846.15 of value of option rights which represented no interest in the transferred property	12
II. The preferred shareholders' per centum of interest is not to be measured by deducting the debentures from the value of the transferred property and computing the interest in the remainder	16

Page

A. Such measure is unsound in fact 16
B. Such measure is unsound in law 18
III. The preferred shares represented the only interest in the transferred property, which remained in the same persons or any of them 18
A. The debentures represented no such interest 18
B. The 31,500 shares of the common stock in petitioner represented no such interest 19

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169 22
Sec. 112 (i) (1) 22
Sec. 113 (a) (7) 22
Sec. 113 (b) (1) (B) 23
Revenue Act of 1934, c. 277, 48 Stat. 680 23
Sec. 23 (1) 23
Sec. 23 (n) 23
Sec. 113 (a) (12) 23
Sec. 113 (b) 24
Sec. 114 (a) 24

AUTHORITIES CITED

Cases

Adamson Flat Glass Co. v. *Commissioner*, 162 F. (2d) 875 ..... 8, 15, 18, 19
Commissioner v. *Shoong* (C.C.A. 9), 177 F. (2d) 131 ..... 7, 16
Continental Insurance Co. v. *United States*, 259 U. S. 156, 177-181 ..... 6, 11
Farrington v. *Tennessee*, 95 U. S. 679, 687 ..... 7, 14
Gibbons v. *Mahon*, 136 U. S. 549, 557 ..... 7, 14, 20
Groman v. *Commissioner*, 302 U. S. 82 19
Helvering v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179 ..... 7, 7, 14, 15, 18, 18, 20
Helvering v. *Southwest Consolidated Corp.*, 315 U. S. 194 ..... 7, 15

Page

Irving Trust Co. v. *United States* (Ct. Cls.), 30 F. Supp. 696, 700 20
Lehigh Metals Co. v. *Commissioner* (1946), 6 T.C. 313, 322 ..... 7, 14, 19
Lehigh Structural Steel Co. v. *Commissioner* (C.C.A. 3), 127 F. (2d) 67, 68 ..... 6, 12
LeTulle v. *Scofield*, 308 U. S. 415 18
Mannington v. *Hocking Valley Railroad Co.* (C.C.S.D. Ohio), 183 Fed. 133, 143 ..... 6, 12
Metropolitan Ice Co. v. *Commissioner* (1935), 32 B.T.A. 588, 593 ..... 7, 14
Niles v. *Ludlow Valve Manufacturing Co.* (C.C.A. 2), 202 Fed. 141, 143 ..... 6, 11
Republic Steel Corporation v. *The United States*, 86 F. Supp. 146 1
Republic Steel Corporation v. *The United States* (1941), 40 F. Supp. 1017 5
Rotenberg v. *Sheehan* (C.C. Mo.), 48 F . Supp. 584, 586 20
Schumacher Wall Board Corp. v. *Commissioner* (1936), 33 B.T.A. 1211, 1214 ..... 7, 14
Van Allen v. *The Assessors*, 70 U. S. 573, 584 ..... 7, 14

MISCELLANEOUS AUTHORITIES

Opinions of General Counsel of Treasury

G.C.M. 7472, C.B. IX-1, 184, 191 (1930) 7, 14, 18
I.T. 2662, XI-2, C.B. 41, 41-43 (1932) 7, 14

Texts

1 *Cook on Corporations* (8th Ed.) 66, Section 12 14
11 *Fletcher Cyclopedia Corporations* (Perm. Ed.) 88, Section 5100 14

Digest

13 American Jurisprudence, 298 14

Statutes

Listed above under Appendix 22

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 98

REPUBLIC STEEL CORPORATION,
Petitioner,

vs.

THE UNITED STATES OF AMERICA,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

To the Honorable Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The petitioner, Republic Steel Corporation, prays that a writ of certiorari issue to review the judgment of the United States Court of Claims entered in the above entitled cause on January 3, 1950 (R. 60).

Opinion Below

The opinion of the United States Court of Claims (R. 54) is reported in *Republic Steel Corporation* v. *United States*, 86 F. Supp. 146.

Jurisdiction

The judgment of the United States Court of Claims was entered January 3, 1950 (R. 60). On February 27, 1950, on motion made therefor and allowed by said Court, petitioner as plaintiff below filed a motion for a new trial which was overruled April 3, 1950 (R. 60). The jurisdiction of this Court is invoked under Sections 1255 and 2101 (c), Title 28, United States Code, June 25, 1948, c. 646, 62 Stat. 928 and 961.

Questions Presented

In determining the basis for depreciation of property acquired October 1, 1928, by a corporation in connection with a reorganization, where under the applicable statute if immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor:

1. Whether the "interest" represented by preferred shares of the transferee, then in the hands of the transferor or its shareholders and comprising a part of the consideration paid by the transferee to the transferor, is measured—

   (a) By $75.00 per share specified in the transferee's Articles of Incorporation to be both the redemption price and the maximum, aside from dividends, ever payable to the preferred shareholders on any liquidation or dissolution of the corporation or on any sale or distribution of its assets; or

   (b) By such shares' then fair market value even though enhanced by the terms of a right attached to each of one class of such shares giving the holder an option to convert such share into common stock of the transferee's parent corporation;

2. Whether the preferred shareholders' per centum of interest in the transferred property immediately after

the transfer is determined by computing such per centum in the then fair market value of the transferred property, or by deducting the amount of the transferee's then outstanding debentures from the then fair market value of the transferred property and computing such per centum in the remainder.

Statutes Involved

The relevant provisions of the applicable statutes are set forth in an Appendix, at pages 22-24 hereof.

Summary and Short Statement of the Matter Involved

In the action below, petitioner as taxpayer and plaintiff sought recovery of $1,406,336.26, with interest, for alleged overpayments of federal income and excess profits taxes of an affiliated subsidiary for the years from 1934 through a part of 1939 (R. 1-26).

Pursuant to a plan of reorganization consummated October 1, 1928, Steel & Tubes, Inc. (herein referred to as Steel & Tubes No. 2), which petitioner had caused to be just organized for that purpose, acquired the assets, including two Johnston patents, of Steel & Tubes, Incorporated (herein referred to as Steel & Tubes No. 1) (R. 27-28, 37-38). The cost to Steel & Tubes No. 2 of, and the October 1, 1928 fair market value of the consideration paid by it for, the assets was $19,556,992.43, inclusive of $12,412,660.39 for the Johnston patents (R. 41). The October 1, 1928, fair market values of the assets and patents were not less than such costs thereof (R. 41). The patents had an unexpired life of 9.893 and 11.123 years, respectively, from October 1, 1928 (R. 39).

Immediately after the transfer petitioner owned and held all, 117,000 shares, of the common stock in Steel & Tubes No. 2 (R. 36), and thereby had all the stock voting rights in such corporation (R. 29), and Steel & Tubes No. 1 or

its shareholders owned and held securities with fair market values as follows, all of which were a part of the consideration paid by Steel & Tubes No. 2 to Steel & Tubes No. 1 for the assets of the latter:

Securities	*October 1, 1928 Fair Market Value*
72,000 Class A preferred shares in Steel & Tubes No. 2	$6,853,486.15
45,000 Class B preferred shares in Steel & Tubes No. 2	3,375,000.00
$4,500,000, 6% debentures in Steel & Tubes No. 2	4,275,000.00
31,500 common shares in petitioner	2,598,750.00

At that time Steel & Tubes No. 2 had no issued or outstanding stocks, debentures or other securities except as above stated (R. 36-38).

As provided in the Articles of Incorporation of Steel & Tubes No. 2 (R. 29):

> The Class A and Class B preferred shares bore cumulative annual dividends not to exceed $4.50 per share and immediately after the transfer there were no accrued unpaid dividends (R. 29).
>
> The Class A and Class B shares were preferred as to assets over the common shares only to the extent of $75.00 per share and accrued unpaid dividends. On any liquidation or dissolution of Steel & Tubes No. 2, or on a sale or distribution of its assets, upon payment to the holders of the Class A and Class B shares of $75.00 per share and accrued unpaid dividends, the remaining assets of Steel & Tubes No. 2 belonged to the holders of the common shares (R. 29-30).
>
> Steel & Tubes No. 2 had the right at its election to redeem all or any of the Class A and Class B shares at $75.00 per share and accrued unpaid dividends (R. 30). Each Class A share bore a right of the holder at his election to have such share redeemed at $75.00 per share

and accrued unpaid dividends (R. 32). Each Class A and Class B share carried a right of the holder at his election to have such share converted by Steel & Tubes No. 2 into common stock in petitioner (R. 32-34), the latter being obligated to furnish sufficient of its common shares to Steel & Tubes No. 2 for that purpose (R. 28-29, 36-37). The terms of such conversion right attached to each Class A share differed from and were much more favorable to the holder than the terms of such conversion right attached to each Class B share (R. 32-34).

Petitioner had no stock or other interest in Steel & Tubes No. 1 either prior to the inception or after the consummation of the plan, but pursuant to the plan and as a step in the consummation thereof, petitioner acquired 11,799 shares of the common stock of Steel & Tubes No. 1 which, pursuant to the plan, were surrendered to and cancelled by Steel & Tubes No. 1 (R. 28, 36-37).

It was held below that the basis to Steel & Tubes No. 2 for depreciation of the Johnston patents for each of the years from 1934 through a part of 1939 was the same as it would be in the hands of the transferor, as contended for by respondent, instead of the cost thereof to the transferee, as claimed by petitioner. The ground of the decision below is that the Class A and Class B preferred shares represented an interest in the transferred property of more than 50% which remained in Steel & Tubes No. 1 or its shareholders (R. 58-59).

The judgment (R. 60) for plaintiff below relates to an agreed dividends paid credit for a part of the year 1939, the amount of which being dependent upon the basis of such patents for depreciation (R. 53, 59).

In *Republic Steel Corporation* v. *The United States* (1941), 40 F. Supp. 1017, there was a final adjudication by the Court of Claims to the effect that the basis for the depreciation of the Johnston patents for the years 1928

and 1929 was their cost to Steel & Tubes No. 2. Under the statute applicable therein, Section 113 (a) (7) of the Revenue Act of 1928, c. 852, 45 Stat. 791, however, the per centum of interest or control in the transferred property was 80 instead of 50. The ground of the decision in the former case was that no control and an interest in such property of less than 80% remained, and it was also held therein that the 11,799 shares of the common stock of Steel & Tubes No. 1, which were acquired by petitioner and surrendered and cancelled as aforesaid, did not represent an interest in transferred property within the meaning of the statute.

Reasons Relied Upon For Allowance of Writ

1. In holding that, regardless of the $75.00 per share limitations in the corporate articles, the preferred shareholders' interest in the transferred property immediately after the transfer is measured by the preferred shares' then fair market value even though enhanced by the terms of the conversion right attached to the Class A shares, the Court of Claims:

> (a) Measured stockholders' interests in corporate property in a way probably in conflict with the general principle that in the absence of controlling statutory law, such interests are determined by the applicable provisions of the corporate charter or other contract between the corporation and its stockholders, which principle was applied, among other cases, in *Continental Insurance Co.* v. *United States,* 259 U. S. 156, 177-181; *Niles* v. *Ludlow Valve Manufacturing Co.,* (C.C.A. 2), 202 Fed. 141, 143; *Lehigh Structural Steel Co.* v. *Commissioner* (C.C.A. 3), 127 F. (2d) 67, 68; and *Mannington* v. *Hocking Valley Railroad Co.* (C.C.S.D. Ohio), 183 Fed. 133, 143;
>
> (b) Decided a federal tax question in a way probably in conflict with the principle announced in *Helvering*

v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179, that stockholders' interests in an insolvent corporation cease when (and consequently must persist until) the creditors have taken steps to enforce their demands against the corporation;

(c) Held that the conversion rights represented a part of the Class A preferred shareholders' interest in the transferred property, which holding is probably in conflict with the principles applied in *Helvering* v. *Southwest Consolidated Corp.*, 315 U. S. 194, determinative of the distinction between stock rights and stock option rights, and is also probably in conflict with an analogous principle applied in *Commissioner* v. *Shoong* (C.C.A. 9), 177 F. (2d) 131, that a conversion right attached to a bond is a right separate and apart from the other rights of the holder of the bond; and

(d) Construed the statutory word "interest" in a way probably in conflict with the long-standing meaning of "ultimate or beneficial species of rights in the nature of ownership * * *" attributed to it by the General Counsel of the Treasury in G.C.M. 7472, C.B. IX-1, 184, 191 (1930), which was approved and followed in I.T. 2662, XI-2, C.B. 41, 41-43 (1932) and *Lehigh Metals Co.* v. *Commissioner* (1946), 6 T.C. 313, 322; which was approved in principle in *Metropolitan Ice Co.* v. *Commissioner* (1935), 32 B.T.A. 588, 593, and *Schumacher Wall Board Corp.* v. *Commissioner* (1936), 33 B.T.A. 1211, 1214; and which accords with the nature of a stock interest as interpreted by this Court in *Van Allen* v. *The Assessors*, 70 U. S. 573, 584; *Farrington* v. *Tennessee*, 95 U. S. 679, 687; *Gibbons* v. *Mahon*, 136 U. S. 549, 557; and *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179, 183-184.

2. In holding that the preferred shareholders' per centum of interest in the transferred property immediately after the transfer is determined by deducting the amount of the then outstanding debentures from the then fair market value of the transferred property and computing such per

centum in the remainder, the Court of Claims in effect erroneously held that such per centum of interest was larger with the debentures outstanding than it would have been had there been no debentures, and thereby decided a federal tax question in a way probably in conflict with:

(a) The decision of the Circuit Court of Appeals, Fourth Circuit, in *Adamson Flat Glass Co.* v. *Commissioner*, 162 F. (2d) 875, 882, in which it was held that claims of creditors could not be taken into account in determining whether a 50% interest remained in property acquired by a corporation in a reorganization, the controlling statutory language therein involved being in all material respects identical to that herein under consideration; and

(b) The principle announced by this Court, which is referred to in the foregoing reason 1 (b) hereof, also the meaning and nature of a stock interest construed as stated in the foregoing reason 1 (d) hereof.

WHEREFORE, petitioner respectfully prays that a writ of certiorari issue to the United States Court of Claims, and submits herewith its brief in support of this petition.

LUTHER DAY,
THOMAS F. PATTON,
EARL W. LEFEVER,
Counsel for Petitioner.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 98

REPUBLIC STEEL CORPORATION,
Petitioner,

vs.

THE UNITED STATES OF AMERICA,
Respondent

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The foregoing petition for a writ of certiorari sets forth references to the opinion below; the grounds upon which jurisdiction is invoked; a statement of the questions presented; the statutes involved; and a summary and short statement of the matter involved.

Specification of Errors To Be Urged

The United States Court of Claims erred:

1. In concluding and holding that the measure of the interest in the transferred property, represented by the preferred shares immediately after the transfer, is such

shares' then fair market value, including the value of the conversion rights attached to the Class A shares;

2. In concluding and holding that the preferred shareholders' per centum of interest in the transferred property immediately after the transfer is determined by deducting the amount of the then outstanding debentures from the then fair market value of the transferred property and computing such per centum in the remainder;

3. In failing to find and hold that immediately after the transfer the preferred shares represented the only interest in the transferred property which remained in the same persons or any of them and that such interest was less than 50%; and

4. In finding and holding that the basis to Steel & Tubes No. 2 for depreciation of the Johnston patents was the same as it would be in the hands of Steel & Tubes No. 1.

Summary of Argument

I. The preferred shareholders' interest in the transferred property immediately after the transfer is not determined by the preferred shares' then market value.

A. Such interest of the preferred shareholders was limited by provisions of the corporate articles to $75.00 per share or a total of $8,775,000, which is less than 50%.

B. Such shares' value of $10,228,846.15 included $1,453,846.15 of value of option rights which represented no interest in the transferred property.

II. The preferred shareholders' per centum of interest is not to be measured by deducting the debentures from the value of the transferred property and computing the interest in the remainder.

A. Such measure is unsound in fact.

1. It does not measure the interest in the transferred property but in only a part thereof.

2. Under it the preferred shareholders' per centum of interest was increased by reason of the debentures.

3. Under it, on the same reasoning and basis of computation, the common shares' interest was 100%.

4. Under it no one had any interest in $4,500,000 worth of the transferred property.

B. Such measure is unsound in law.

III. The preferred shares represented the only interest in the transferred property, which remained in the same persons or any of them.

A. The debentures represented no such interest.

B. The 31,500 shares of the common stock in petitioner represented no such interest.

ARGUMENT

I. The Preferred Shareholders' Interest in the Transferred Property Immediately After the Transfer Is not Determined by the Preferred Shares' Then Market Value

A. *Such interest of the preferred shareholders was limited by provisions of the corporate articles to $75.00 per share or a total of $8,775,000, which is less than 50%*

It is a general principle of law that in the absence of any controlling statute, stockholders' interests in their corporation's property are determined by the applicable provisions of the corporate charter or other contract between the corporation and its stockholders. Among the many cases in which that principle was applied are *Continental Insurance Co.* v. *United States,* 259 U. S. 156, 177-181; *Niles* v. *Ludlow Valve Manufacturing Co.* (C.C.A. 2), 202

Fed. 141, 143; *Lehigh Structural Steel Co.* v. *Commissioner* (C.C.A. 3), 127 F. (2d) 67, 68; and *Mannington* v. *Hocking Valley Railroad Co.* (C.C.S.D. Ohio), 183 Fed. 133, 143.

The findings below (R. 29) disclose that under provisions of the Articles of Incorporation of Steel & Tubes No. 2: the preferred shares were preferred as to assets over the common shares only to the extent of $75.00 per share and accrued unpaid dividends; on any liquidation or dissolution of the corporation or on sale or distribution of its assets, upon payment to the preferred shareholders of $75.00 per share and accrued unpaid dividends, the remaining assets of the corporation belonged to the holders of the common shares; and the corporation had the right at its election to redeem all or any of the preferred shares at $75.00 per share and accrued unpaid dividends. Immediately after the transfer there were of course no accrued unpaid dividends.

It follows that the then interest of the preferred shareholders in the transferred property was so limited by such provisions of the corporate articles that it could not have exceeded $75.00 per share or a total of $8,775,000, which is less than 50% of the $19,556,992.43 (R. 41) fair market value of the transferred property.

B. *Such shares' value of $10,228,846.15 included $1,453,846.15 of value of option rights which represented no interest in the transferred property*

The findings below (R. 29-35) disclose that aside from their names and the number of shares of each authorized and issued, the Class A and the Class B shares were identical, except for two differences. The one was that the holders of the Class A shares had the right at their election to have all or any of their shares redeemed at $75.00 per share and accrued unpaid dividends, whereas the holders of the Class B shares had no such right (R. 32), although

both the Class A and the Class B shares were redeemable all or in part at the option of Steel & Tubes No. 2 (R. 30). The other was that although the holders both of the Class A shares and the Class B shares had the right at their election to convert all or any of their shares into common stock of petitioner, the basis for such conversion of the Class A shares was much more favorable [1] than was the basis for such conversion of the Class B shares (R. 32-34, 41).

Thus, upon the findings below, it must be true that it was solely because of either or both of such option rights' differences that immediately after the transfer, as shown by finding 15 (R. 41), the 45,000 Class B shares had a fair market value of only $3,375,000.00 (which is at the rate of $75.00 per share), whereas the 72,000 Class A shares had a fair market value of $6,853,846.15 (which is at the rate of $95.19230 per share, or a total of $1,453,846.15 in excess of $75.00 per share). It necessarily follows that a $1,453,846.15 part of the $10,228,846.15 (representing the fair market value of the Class A and the Class B shares immediately after the transfer) was at that time attributable solely to either or both of the option rights' differences above referred to.

The remainder of $10,228,846.15 less $1,453,846.15 is $8,775,000, which is less than 50% of the $19,556,992.46 (R. 41) market value of the transferred property.

The word "interest" in the applicable statute (Section 113 (a) (7) of the Revenue Act of 1932) and in corresponding sections of many earlier and later revenue acts, has never been construed by this Court. The General Counsel for the Treasury construed it to mean: "that ultimate or

---

[1] In fact, each Class A share, if then converted, would have given the holder one share of common stock in petitioner (then of the value of $82.50) plus $10.00 in cash (R. 32-33, 41), whereas each Class B share if so converted would have given to the holder one share of the common stock in petitioner, provided that such holder paid $7.50 to boot to effect the conversion (R. 34, 41).

beneficial species of rights, in the nature of ownership, which the individual shareholder has in property the direct ownership of and the beneficial and legal title to which is in a corporation of which the individual is a shareholder" (G.C.M. 7472, C.B. IX-1, 184, 191-192 (1930)). That construction of the word has been approved and followed in I.T. 2662, XI-2, C.B. 41, 42-43 (1932) and *Lehigh Metals Co.* v. *Commissioner* (1946), 6 T.C. 313, 322, and has been approved in principle in *Metropolitan Ice Co.* v. *Commissioner* (1935), 32 B.T.A. 588, 593, and *Schumacher Wall Board Corp.* v. *Commissioner* (1936), 33 B.T.A. 1211, 1214. That construction of the word accords with the nature of a stock interest in corporate property as interpreted by this Court in *Van Allen* v. *The Assessors*, 70 U. S. 573, 584; *Farrington* v. *Tennessee*, 95 U. S. 679, 687; *Gibbons* v. *Mahon*, 136 U. S. 549, 557; and *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179, 183-184.

Even under the general corporation law, the interest which a stockholder has in his corporation's property accords precisely with the foregoing meaning of the particular interest called for in the applicable statute. Supported by the many authorities therein cited, in 13 American Jurisprudence, 298, appears the following:

> "A share of stock is a unit of interest in a corporation. While ownership thereof confers no immediate title to any of the property of the corporation, it entitles the shareholder to an aliquot part of the property, or its proceeds, to the extent indicated, when distributed according to law and equity. Each share represents a distinct and undivided share or interest in the common property of the corporation."

Similarly, see 11 Fletcher *Cyclopedia Corporations* (Perm. Ed.) 88, Section 5100 and cases cited therein; and *1 Cook on Corporations* (8th Ed.) 66, Section 12 and cases cited therein.

On the basis of the foregoing authorities, and it is confidently submitted that, except for the decision below in the instant case, there is no authority in disagreement therewith, it is clear that all of the outstanding shares in a corporation represent a 100% interest, i.e., 100% of the ultimate or beneficial rights in the nature of ownership, which shareholders have in their corporation's property, irrespective of the market value of the shares. It follows, contrary to the holding below, that the very nature of a stock interest in a corporation's property is such that the per centum of the interest is not to be determined by the market value of the stock.

The conclusion last above stated is implicit in the ruling of this Court in *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179 (followed in *Adamson Flat Glass Co.* v. *Commissioner* (C.C.A. 4), 162 F. (2d) 875, 881-882) that stockholders' interests in an insolvent corporation cease when (and consequently must persist until) the creditors have taken steps to enforce their demands against the corporation. The holding below is in obvious conflict with that ruling because the market value measure is irreconcilable therewith.

Moreover, since the preferred shares' value of $10,228,-846.15 included $1,453,846.15 of option rights value, the holding below necessarily implies that such option rights as such also represented an interest in the transferred property. That implication is erroneous. When and if exercised, such options gave the holders mere contract rights to acquire from Steel & Tubes No. 2 common stock in petitioner. Thus, the options were not only devoid of any ultimate or beneficial rights in the nature of ownership in, but they were wholly unrelated to, the transferred property.

The implication last above referred to is irreconcilable with the principles applied in *Helvering* v. *Southwest Con-*

solidated Corp., 315 U. S. 194, determinative of the distinction between stock rights and stock option rights. It is also in conflict with analogous principles applied in *Commissioner* v. *Shoong* (C.C.A. 9), 177 F. (2d) 131, in determining that a conversion right attached to a bond is a right separate and apart from the other rights of the holder of the bond.

II. The Preferred Shareholders' Per Centum of Interest Is not to Be Measured by Deducting the Debentures from the Value of the Transferred Property and Computing the Interest in the Remainder.

A. *Such measure is unsound in fact.*

In the decision below it was held that even if the preferred shareholders' interest in the transferred property immediately after the transfer was $75.00 per share or a total of $8,775,000, as limited by provisions of the corporate articles, still such interest exceeded 50%. That result rests solely upon the further holding below that since the debenture claims had priority over all stock claims, the $4,500,000 in debentures[2] must be deducted from the $19,556,992.43 (R. 41) market value of the transferred property and the preferred shareholders' interest in the transferred property was that per centum of interest which the preferred shares at $75.00 per share (or a total of $8,775,000) represented in the remainder.

Mathematically stated, it was held below in effect that the preferred shareholders' per centum of interest in the transferred property, with the debentures outstanding, was $8,775,000 divided by $15,056,992.43 ($19,556,992.43 less $4,500,000) or 58.27+%, whereas had there been no deben-

[2] The court below expressly declined to hold that the debentures represented an interest in the transferred property (R. 57).

tures outstanding, it would have been $8,775,000 divided by $19,556,992.43, or 44.86+%.

If in computing the preferred shares' per centum of interest in the transferred property, the amount of the debentures must be deducted and the computation made in the remainder, then upon the same reasoning, in computing the common shares' per centum of interest in the transferred property, both the $4,500,000 and the $8,775,000 must be deducted and the computation made in the remainder. Thus, were the reasoning below sound, it would necessarily follow that petitioner, holder of all the common shares, had a 100% interest in the transferred property because that interest comprised all of the remainder of $19,556,992.43, less the sum of the $4,500,000 in debentures and the $8,775,000 in preferred shares.

From the foregoing it is obvious that the measure used below is unsound, among other reasons, because:

1. Contrary to the terms of the applicable statute, it does not measure the interest in the transferred property but in only a part thereof;

2. Thereunder the preferred shareholders' interest in the transferred property was 58.27+% with the debentures outstanding and only 44.86+% had there been no debentures, which not only could not be true, but is directly contrary to the conclusion below that the debentures decreased the preferred shares' interest (R. 58);

3. The preferred shares' interest was 58.27+%, yet on the same reasoning and basis of computation, the common shares' interest was 100%, which of course could not be true; and

4. Thereunder no one had any interest in $4,500,000 worth of the transferred property, which is an obvious fallacy.

B. *Such measure is unsound in law*

In holding that the debentures should be deducted from the value of the transferred property and that the preferred shareholders' interests should be computed in the remainder, the decision below is in irreconcilable conflict with:

1. The decision in *Adamson Flat Glass Co.* v. *Commissioner* (C.C.A. 4), 162 F. (2d) 875, 882, in which it is held that claims of creditors should not be taken into account in determining whether a 50% interest remained in property acquired in a reorganization, the controlling statutory language therein involved being in material respects identical with that herein under consideration;

2. The principle in *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179, that stockholders' interests in an insolvent corporation cease when (and consequently must persist until) the creditors have taken steps to enforce their demands against the corporation; and

3. The long-standing meaning of the word "interest" which is attributed to it by the General Counsel of the Treasury and which is approved and followed as previously stated on page 13 of this brief.

III. The Preferred Shares Represented the Only Interest in the Transferred Property, Which Remained in the Same Persons or Any of Them

A. *The debentures represented no such interest*

That debentures (where the holders thereof have taken no steps to enforce their claims) do not represent an "interest" in the issuing corporation's property appears to follow directly from *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S.

179, because the absence of any *continuity* of interest in a transferee in a reorganization necessarily implies an absence of any interest in the transferred property, which *remained* in the transferor or its shareholders. The decision last referred to was so construed and followed with that result in *Adamson Flat Glass Co.* v. *Commissioner* (C.C.A. 4), 162 F. (2d) 875, 879-880. In *Lehigh Metals Co.* v. *Commissioner,* 6 T.C. 313, 322, it was held that prior lien notes represented no "interest or control" in the issuing corporation's property within the meaning of Section 113 (a) (7) of the Revenue Act of 1928 (c. 852, Stat. 791) which, except that the required per centum therein was 80 instead of 50, is identical to the corresponding section in the 1932 Act, herein involved.

B. *The 31,500 shares of the common stock in petitioner represented no such interest*

The 31,500 shares of common stock in petitioner which constituted a part of the consideration for the transferred property, did not represent an interest in the transferred property. That conclusion is well supported and apparently there is no supporting authority to the contrary, notwithstanding the fact, commented upon in the opinion below (R. 59), that petitioner owned the common shares of Steel & Tubes No. 2 which in turn owned the transferred property.

Groman v. *Commissioner,* 302 U. S. 82, appears to be decisive of this question, even though the question therein was whether The Glidden Company was a party to a reorganization. Since it was held in the *Groman* case that the Glidden prior preference shares represented no continuity of interest in the transferee therein, it appears necessarily to follow that such shares represented no interest in the transferred property therein which remained in the same persons or any of them. An absence of any

B. *Such measure is unsound in law*

In holding that the debentures should be deducted from the value of the transferred property and that the preferred shareholders' interests should be computed in the remainder, the decision below is in irreconcilable conflict with:

1. The decision in *Adamson Flat Glass Co.* v. *Commissioner* (C.C.A. 4), 162 F. (2d) 875, 882, in which it is held that claims of creditors should not be taken into account in determining whether a 50% interest remained in property acquired in a reorganization, the controlling statutory language therein involved being in material respects identical with that herein under consideration;

2. The principle in *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179, that stockholders' interests in an insolvent corporation cease when (and consequently must persist until) the creditors have taken steps to enforce their demands against the corporation; and

3. The long-standing meaning of the word "interest" which is attributed to it by the General Counsel of the Treasury and which is approved and followed as previously stated on page 13 of this brief.

III. The Preferred Shares Represented the Only Interest in the Transferred Property, Which Remained in the Same Persons or Any of Them

A. *The debentures represented no such interest*

That debentures (where the holders thereof have taken no steps to enforce their claims) do not represent an "interest" in the issuing corporation's property appears to follow directly from *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S.

179, because the absence of any *continuity* of interest in a transferee in a reorganization necessarily implies an absence of any interest in the transferred property, which *remained* in the transferor or its shareholders. The decision last referred to was so construed and followed with that result in *Adamson Flat Glass Co.* v. *Commissioner* (C.C.A. 4), 132 F. (2d) 875, 879-880. In *Lehigh Metals Co.* v. *Commissioner*, 6 T.C. 313, 322, it was held that prior lien notes represented no "interest or control" in the issuing corporation's property within the meaning of Section 113 (a) (7) of the Revenue Act of 1928 (c. 852, Stat. 791) which, except that the required per centum therein was 80 instead of 50, is identical to the corresponding section in the 1932 Act, herein involved.

B. *The 31,500 shares of the common stock in petitioner represented no such interest*

The 31,500 shares of common stock in petitioner which constituted a part of the consideration for the transferred property, did not represent an interest in the transferred property. That conclusion is well supported and apparently there is no supporting authority to the contrary, notwithstanding the fact, commented upon in the opinion below (R. 59), that petitioner owned the common shares of Steel & Tubes No. 2 which in turn owned the transferred property.

Groman v. *Commissioner*, 302 U. S. 82, appears to be decisive of this question, even though the question therein was whether The Glidden Company was a party to a reorganization. Since it was held in the *Groman* case that the Glidden prior preference shares represented no continuity of interest in the transferee therein, it appears necessarily to follow that such shares represented no interest in the transferred property therein which remained in the same persons or any of them. An absence of any

continuity of interest implies an absence of any interest which *remained.* It was concluded in *Helvering* v. *Alabama Asphaltic Limestone Co.,* 315 U. S. 179, 183, that: "The equity interest in the parent is one step removed from the equity interest in the subsidiary". In *Rotenberg* v. *Sheehan* (C.C. Mo.), 48 F. Supp. 584, 586, on authority of the *Groman* case, it was held that stock in a parent company, received by a transferor as part of the consideration for the transferor's conveyance of its assets to a subsidiary of the parent company, did not represent a continuing interest in the transferred property, but represented instead "a new and different interest".

Moreover, under the requirement of the applicable statute, the interest which "remained" must have been an "interest in such property," viz., the transferred property. *Irving Trust Co.* v. *United States* (Ct. Cls.), 30 F. Supp. 696, 700. One hundred percent of such interest (ultimate or beneficial rights in the nature of ownership) was represented by all the stock of Steel & Tubes No. 2 which had legal title to the transferred property. *Gibbons* v. *Mahon,* 136 U. S. 549, 557, supports that conclusion. The common stock in petitioner therefore constituted no part of such one hundred percent.

Even if such 31,500 shares of common stock in petitioner should be determined to represent an interest in the transferred property, which remained in the same persons or any of them, still such interest added to the interest represented by the preferred shares would not be sufficient to equal 50%. Proof of this conclusion is furnished by the number of shares of petitioner's common stock then outstanding.

It was stipulated below that plaintiff's (petitioner's) Exhibit 1 (R. 62) is a true copy of an agreement duly entered into in writing on August 14, 1928, by and between peti-

tioner (formerly Republic Iron and Steel Company) (R. 27) and Steel & Tubes No. 1; that all statements, representations and understandings of facts set forth in such Exhibit 1 were true (R. 61-62); and that it was pursuant to such agreement that Steel & Tubes No. 2 acquired all of the assets of Steel & Tubes No. 1 (R. 62). In such agreement, dated August 14, 1928, page 1 (R. 62), it is stated that Republic Iron and Steel Company (petitioner) then had an authorized issue of 1,000,000 shares of common stock, of which 596,030 shares were issued and outstanding. Thereafter on October 1, 1928, the 31,500 shares were issued (R. 36-37), giving a total of 627,530 shares then issued and outstanding.

Under the previous argument I A herein (*supra*, pp. 11-12), it was demonstrated that the preferred shares represented an interest in the transferred property of only $8,775,000. Thus petitioner's 117,000 common shares in Steel & Tubes No. 2, represented immediately after the transfer, a per centum of interest in the transferred property evidenced by $10,781,992.43 ($19,556,992.43 less the preferred shares' interest of $8,775,000). But 31,500/627,530 times $10,781,992.43 amounts to only $541,221.55, whereas the $8,775,000 in preferred stock, plus $541,221.55 in common stock in petitioner, equals only $9,316,221.55, which would be $462,274.66 less than 50% of $19,556,992.43.

Respectfully submitted,

LUTHER DAY,
THOMAS F. PATTON,
EARL W. LEFEVER,
Counsel for Petitioner.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 112. Recognition of Gain or Loss.

(i) Definition of Reorganization.—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

* * * * *

SEC. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * *

(7) Transfers to corporation where control of property remains in same persons.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. * * *

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) General rule.—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

* * * * *

(l) Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

(n) Basis for Depreciation and Depletion.—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

SEC. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * *

(12) Basis established by Revenue Act of 1932.—If the property was acquired, after February 28,

1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932 was prescribed by section 113 (a) (6), (7) or (9) of such Act, then for the purposes of this Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

* * * * *

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

SEC. 114. Basis for Depreciation and Depletion.

(a) Basis for Depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

Sections 23 (l) and (n), 113 (a) (12) and (b), and 114 (a) of the Revenue Acts of 1936, c. 690, 49 Stat. 1648, 1938, c. 289, 52 Stat. 447, and the Internal Revenue Code are in all material respects the same as the above quoted provisions of the Revenue Act of 1934.

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	1
Statutes involved	2
Statement	2
Argument	8
Conclusion	14
Appendix	15

CITATIONS

Cases:	
Irving Trust Co. v. *United States*, 30 F. Supp. 696, certiorari denied, 311 U. S. 685	12
Lehigh Metals Co. v. *Commissioner*, 6 T. C. 313	12
Muskegon Motor Specialties Co. v. *Commissioner*, 134 F. 2d 904, certiorari denied, 320 U. S. 741	12
Republic Steel Corp. v. *United States*, 40 F. Supp. 1017	9
Statutes:	
Internal Revenue Code:	
Sec. 23 (26 U.S.C. 1946 ed., Sec. 23)	18
Sec. 113 (26 U.S.C. 1946 ed., Sec. 113)	18
Sec. 114 (26 U.S.C. 1946 ed., Sec. 114)	18
Revenue Act of 1932, c. 209, 47 Stat. 169:	
Sec. 112	15
Sec. 113	9, 15
Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 23	16
Sec. 113	9, 17
Sec. 114	17
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 23	18
Sec. 113	9, 18
Sec. 114	18
Revenue Act of 1938, c. 289, 52 Stat. 447:	
Sec. 23	18
Sec. 113	9, 18
Sec. 114	18
Miscellaneous::	
Treasury Regulations 101, Art. 113(a)(7)-1	12

In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 98

REPUBLIC STEEL CORPORATION, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

OPINION BELOW

The opinion of the Court of Claims (R. 54-59) is reported in 86 F. Supp. 146.

JURISDICTION

The judgment of the court below was entered January 3, 1950. (R. 60.) On February 27, 1950, plaintiff filed a motion for a new trial which was overruled on April 3, 1950. (R. 60.) The petition for a writ of certiorari was filed May 31, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255(1).

QUESTION PRESENTED

Corporation A transferred all its property to Corporation B in exchange for, among other things, all the preferred stock of Corporation B. Corporation C acquired all the common stock of Corporation B. The preferred stock of Corporation B had a fair market value in excess of that of its common

stock and the number of preferred shares was equal to the number of shares of common stock.

The issue is whether, as the court below held, immediately after the transfer, Corporation A had an interest of 50% or more in the property transferred within the provisions of Section 113(a)(7), Revenue Act of 1932, so that the basis of the property to B is the same as it was in the hands of A.

STATUTES INVOLVED

The applicable portions of the pertinent statutes are set forth in the Appendix, *infra,* pp. 15-18.

STATEMENT

The special findings of fact of the Court of Claims (R. 27-53) may be summarized as follows:

Steel and Tubes, Incorporated, hereinafter referred to as Steel & Tubes No. 1, was an Ohio corporation incorporated on August 7, 1902. Its principal office and place of business was at Elyria, Ohio. (R. 27.) On or about October 15, 1928, its charter was abandoned and this corporation ceased to exist. (R. 38.) Its charter was cancelled on November 15, 1930. (R. 27.)

Steel & Tubes, Inc., hereinafter referred to as Steel & Tubes No. 2, was also an Ohio corporation organized on September 17, 1928, and dissolved on October 13, 1939. Its principal office and place of business was at Elyria, Ohio. It was caused to be incorporated by and at all times during its corporate existence was an affiliate of the taxpayer. (R. 27.)

Taxpayer is and at all times material was a New Jersey corporation with its principal office and

place of business at Cleveland, Ohio, since 1936. (R. 27.) Its tax liability here is that of a transferee of Steel & Tubes No. 2.

Pursuant to appropriate authorizations, the taxpayer and Steel & Tubes No. 1 executed a written agreement dated August 14, 1928, wherein the two corporations agreed that the taxpayer would organize a new corporation, Steel & Tubes No. 2, to which Steel & Tubes No. 1 would transfer all of its assets in consideration of and in exchange for certain debentures and certain Class A and Class B stock to be issued by the new corporation, together with other considerations, including an agreement that all of the liabilities and obligations of Steel & Tubes No. 1, except common stock, and all liabilities and obligations of its subsidiaries would be assumed by the new corporation. (R. 27-28.)

On September 30, 1928, after the organization of the new corporation known as Steel & Tubes No. 2 and pursuant to proper authorization, that corporation and the taxpayer executed a written agreement, to which was attached a copy of the written agreement dated August 14, 1928, providing in part that the taxpayer would advance to the new corporation funds sufficient to cover its organization expenses and also cash, securities, and bonds sufficient to cover the liabilities of Steel & Tubes No. 1, which were to be assumed pursuant to the agreement. (R. 28.) This agreement also provided that the taxpayer would receive all of the common stock of Steel & Tubes No. 2, aggregating 117,000 shares. (R. 29).

As required by the agreement dated August 14, 1928, the articles of incorporation of Steel & Tubes No. 2 provided in part for the issue of 72,000 Class A shares and 45,000 Class B shares of stock without par value and 117,000 shares of common stock; for payment of cumulative annual dividends upon all except common stock of not to exceed $4.50 per share. It also provided that voting rights with respect to the affairs of the corporation would be vested in the holders of the common stock, and that the holders of Class A and Class B stock, without preference or priority of one over another, were to be preferred as to assets over the holders of the common stock to the extent of an amount equal to $75 per share and accrued unpaid dividends thereon. (R. 29.)

On October 1, 1928, pursuant to the written agreement dated September 30, 1928, Steel & Tubes No. 2 issued all of its common stock (117,000 shares) to the taxpayer. (R. 36.) Steel & Tubes No. 2 acquired all of the assets of Steel & Tubes No. 1, excepting only its corporate franchise and assumed all of its liabilities, excepting only those attributable to its outstanding common stock. It paid to Steel & Tubes No. 1 or its order all sums covered by the written agreement between the two corporations and delivered its 117,000 shares of Class A and Class B preferred stock, mentioned above, its debentures in the face amount of $4,500,000, and also 31,500 shares of common stock of the

taxpayer. (R. 37.) All its common stock, 117,000 shares, was issued to the taxpayer. (R. 36.)

All of the terms of the written agreements dated August 14, 1928, and September 30, 1928, were fully performed by the parties. All of the debentures, mentioned above, were redeemed in 1936. (R. 39.)

Included among the assets acquired on October 1, 1928, by Steel & Tubes No. 2 from Steel & Tubes No. 1 were two patents having a remaining unexpired life at that time. (R. 39.)

The fair market value as of October 1, 1928, of the consideration paid by Steel & Tubes No. 2 to Steel & Tubes No. 1 for the assets of the latter with an allocation of such consideration to the respective securities involved is as follows (R. 41):

72,000 shares Class A stock		$6,853,846.15
45,000 shares Class B stock		3,375,000.00
31,500 shares R. I. and S. Company common stock		2,598,750.00
4,500,000 6 percent debenture		4,275,000.00
Indebtedness of Steel and Tubes, Incorporated, retired as part of consideration:		
Preferred stock	$357,800.00	
Dividend	24,151.50	
		381,951.50
Bonds of Elyria Iron and Steel Realty Company:		
Principal	360,000.00	
Premium	7,200.00	
		367,200.00
Mortgage of Steel and Tubes, Incorporated, of New York:		
Principal	355,000.00	
Interest	3,550.00	
		358,550.00
11,799 common shares of Steel and Tubes, Incorporated, owned by Republic, surrendered for cancellation as part of consideration		1,346,694.78
Total		19,556,992.43

The cost to Steel & Tubes No. 2 of the assets acquired by it from Steel & Tubes No. 1 was $19,556,-

992.43 and the October 1, 1928, fair market value of such assets was not less than that amount. The cost to Steel & Tubes No. 2 of the two Johnston patents above referred to was $12,412,660.39, and the October 1, 1928, fair market value of such two patents was not less than that amount. (R. 41.)

The fair market value paid by the taxpayer and the fair market value of the 117,000 shares of common stock of Steel & Tubes No. 2 which it acquired was $5,053,146.28. The consideration which the taxpayer paid included the following: 31,500 shares of its common stock, having a fair market value of $2,598,750.00, transferred to Steel & Tubes No. 1; $1,346,694.78 paid for stock of Steel & Tubes No. 1 which were cancelled; $381,951.50, paid to redeem preferred stock of Steel & Tubes No. 1; $725,750.00 paid to redeem outstanding indebtedness of Steel & Tubes No. 1. (R. 28, 36-37, 41.)

No gain or loss was recognized by the Commissioner of Internal Revenue on the transaction whereby Steel & Tubes No. 2 acquired the assets of Steel & Tubes No. 1. (R. 41.)

The taxpayer was affiliated with Steel & Tubes No. 2 during the years 1928 and 1929 for federal income tax purposes. Returns filed by Steel & Tubes No. 2 for each of those years reported its federal income tax upon a net income reduced by depreciation for the Johnston patents calculated upon their cost to it on October 1, 1928. (R. 41.) The Commissioner of Internal Revenue assessed deficiencies for each year upon the basis that de-

preciation for the patents was the same as it would be in the hands of the transferor. Those deficiencies were paid, claims for refund thereof duly filed and disallowed and suit instituted, which went to judgment in favor of the taxpayer for $196,584.74, with interest as provided by law. *Republic Steel Corp.* v. *United States,* 40 F. Supp. 1017 (C. Cls.) That judgment was paid and satisfied. It is now final. (R. 42.)

In federal tax returns filed by Steel & Tubes No. 2 for each of the calendar years 1930 through 1933, the cost of the assets acquired by that taxpayer on October 1, 1928, including the two Johnston patents, was used as the basis for computing deductions for depreciation. No deficiencies were assessed by the Commissioner for any of those years. (R. 42.)

Federal income and excess profits tax returns filed by Steel & Tubes No. 2 for each of the calendar years 1934, 1935, and 1938 reported no taxable income in those years and no tax due. (R. 42.) Similar returns filed by the same taxpayer for the calendar years 1936 and 1937 and for that portion of the calendar year ended September 30, 1939, reported taxes due which were paid in quarterly installments. (R. 43.) In computing its net taxable income for each such year, Steel & Tubes No. 2 deducted amounts for depreciation of the two Johnston patents based upon the cost of such patents to it as of October 1, 1928, and an unexpired life for such patents of 9 11/12 years. (R. 44.)

Income tax deficiencies for the calendar years 1934 through 1939, inclusive, were assessed on December 23, 1943, against taxpayer, as transferee of Steel & Tubes No. 2, in an aggregate principal sum of $877,705.23, together with excess profits taxes for such years in the aggregate principal sum of $73,179.60, plus interest in the amount of $372,307.63, making a total sum of principal and interest of $1,323,192.46, which sum was paid by the taxpayer on December 28, 1943. (R. 49.) Such deficiencies resulted, in part, from proposed adjustments of claimed deductions for patent amortization. (R. 44, 48.) In calculating such deficiencies, the Commissioner of Internal Revenue allowed depreciation upon the Johnston patents which was based upon their remaining undepreciated cost to Steel & Tubes No. 1 and refused to allow depreciation or amortization of such patents upon the basis of their cost to Steel & Tubes No. 2 on October 1, 1928. (R. 51-53.)

The taxpayer as transferee of Steel & Tubes No. 2 filed timely and sufficient formal claims for refund for the calendar years 1934 to 1939, both inclusive. The Commissioner of Internal Revenue took no formal action upon any of these refund claims. (R. 50.)

ARGUMENT

1. The decision below is correct. The ultimate issue presented concerns the basis for depreciation of two patents acquired by Steel & Tubes No. 2 in

a reorganization on October 1, 1928, namely, whether the depreciation basis is that of the transferor, as ruled by the Commissioner and as held by the Court of Claims, or whether the basis is to be cost to the transferor, as contended for by the taxpayer. There is no dispute that the decision below is correct if the situation falls within the provisions of Section 113(a)(7), Revenue Act of 1932 (Appendix, *infra*). That section (applicable because of the provisions of Section 113(a)(12), Revenue Acts of 1934, 1936, and 1938 (Appendix, *infra*)) provides that the basis shall be that of the transferor where property was acquired by a corporation in connection with a reorganization and, immediately after the transfer, "an interest or control in such property of 50 per centum or more remained in the same persons or any of them * * *."

The only question concerning the applicability of the statute centers on whether Steel & Tubes No. 1, the transferor, had an interest of 50% or more in the property immediately after its transfer to Steel & Tubes No. 2. As a preliminary matter, it will be noted that the same issue was involved in *Republic Steel Corp.* v. *United States,* 40 F. Supp. 1017 (C. Cls.), where, under the same facts, but involving Section 113(a)(7) of the Revenue Act of 1928, c. 852, 45 Stat. 791, it was held that that section, which required the retention of an 80% interest rather than a 50% interest, was not applicable on the sole ground that the retained interest was

less than 80%. The Court of Claims there found it unnecessary to determine the exact percentage of the retained interest. In the present case, it did determine that the retained interest exceeded 50% and that the requirements of Section 113(a)(7), in the form applicable to this case, have been met.

After the reorganization, the only parties having a statutory interest in the property transferred to Steel & Tubes No. 2 were Steel & Tubes No. 1, the transferor, and Republic Steel, they, together, owning all the outstanding securities of the transferee. The requirements of the statute are met if, as the Court of Claims observed (R. 55-56), "the interest in the property which Steel and Tubes No. 1 retained was greater than that acquired by the Republic Steel Corporation, * * *." If, as the taxpayer contends, the interest retained by the transferor should not include the debentures issued to it by the transferee and should not include the common stock of Republic Steel which was transferred to it, so that its interest in the property after the reorganization would be limited to the preferred stock of the transferee which it received, it is nevertheless plain that the interest retained by the transferor was greater than that acquired by Republic Steel and, consequently, exceeded the statutory requirement of 50%. That is, the transferor received all the Class A preferred stock, with a market value of $6,853,846.15, and all the Class B preferred stock, with a market value of $3,375,-

000, or stock of a combined fair market value of $10,228,846.15, while the fair market value of the common stock of the transferee which Republic Steel acquired was, as was previously noted, *supra*, p. 6, $5,053,146.28. Quite plainly, the interest retained by the transferor exceeded 50% of all the outstanding interests in the property acquired by the transferee. The Court of Claims was clearly correct, on this basis, in holding that the statutory requirements had been met.

The taxpayer, in an attempt to reduce the transferor's interest to less than 50%, advances the following contentions: (1) the transferor's interest should be measured by the value which the preferred shares would receive on liquidation, rather than by their fair market value immediately after the transfer (Pet. 6-7; Br. 11-12); (2) the Court of Claims (which had demonstrated, as an alternative ground of its decision, that the statute would apply even if liquidating values could be accepted (R. 56-59)) was wrong in calculating the liquidating value of the preferred stock on the assumption that the corporation would first pay off its debentures (Br. 16-19); (3) the fair market value of the preferred stock reflected certain option rights and, consequently, was not a fair measure of the interest in the property represented by the preferred stock (Pet. 7; Br. 12-16). On the basis of these contentions, the taxpayer urges that all the preferred stock received by the transferor had a value of $8,775,000 (Br. 12-13) and that this was

less than 50% of the value of the property transferred (Br. 12, 13, 21).

The basic fallacy of the taxpayer's argument lies in the assumption that the interest in the property retained by the transferor is to be measured against the property transferred. This is plainly wrong. Whether the transferor retained an interest of 50% or more in the property can only be determined by comparing the interest which the transferor acquired in the transferee corporation with the other outstanding interests in that corporation. *Irving Trust Co.* v. *United States,* 30 F. Supp. 696, 702 (C. Cls.), certiorari denied, 311 U. S. 685; *Muskegon Motor Specialties Co.* v. *Commissioner,* 134 F. 2d 904 (C.A. 6th), certiorari denied, 320 U. S. 741; *Lehigh Metals Co.* v. *Commissioner,* 6 T. C. 313, 321; Article 113(a)(7)-1, Example (2), Treasury Regulations 101, promulgated under the Revenue Act of 1938. Here, the interest of Republic Steel's common stock, the only other proprietary interest outstanding, was $5,053,146.28 and the interest of the transferor, even on the taxpayer's contention that the preferred stock was worth only $8,775,000 and that this was the only interest acquired by the transferor, exceeded 50% of all outstanding interests.

Even if the market value of the shares should not be considered and the interests should be measured only by the number of shares acquired,

the requirements of the statute would be met. That is, the transferor received 72,000 shares of the Class A preferred stock and 45,000 shares of the Class B preferred stock, a total of 117,000 shares. Since Republic Steel received 117,000 shares of common stock, the transferor had 50% of the number of shares outstanding, regardless of their value.

Accordingly, it is unnecessary to discuss the soundness of the various assumptions made by the taxpayer or to analyze the cases which are cited in support of those propositions and which are asserted to be opposed to the situation here, for, even if they could be assumed to possess validity, they would not establish the taxpayer's ultimate contention that the requirements of the statute have not been met.

2. There is no conflict in decisions. The various decisions which the taxpayer relies on as interpreting the term "interest" in the statute in a different manner (Pet. 6-7; Br. 14, 15-16, 18-19, 20) are not opposed to the decision below. Most of the cases involved different problems under different statutory provisions, and have nothing to do with the issue presented by this case. Moreover, as we have shown, even if the interest of the transferor be limited to the preferred stock which it received and even if that be given the narrowest possible scope, the statute would govern. Accordingly, there can be no conflict in decisions.

CONCLUSION

The decision below is correct. There are no conflicting decisions. No other reason exists which would warrant further review.

Respectfully submitted,

ARNOLD RAUM,
Acting Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
ELLIS N. SLACK,
HILBERT P. ZARKY,
JOHN A. REES,
Special Assistants to the Attorney General.

JULY, 1950.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(i) *Definition of Reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to corporation where control of property remains in same persons.*—If the property was acquired after December 31, 1917, by a corporation in connection

with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property

used in the trade or business, including a reasonable allowance for obsolescence. * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(12) *Basis established by Revenue Act of 1932.*—If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932 was prescribed by section 113(a)(6), (7), or (9) of such Act, then for the purposes of this Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescenc are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

Sections 23(l) and (n), 113(a)(12) and (b), and 114(a) of the Revenue Acts of 1936, c. 690, 49 Stat. 1648, 1938, c. 289, 52 Stat. 447, and the Internal Revenue Code are in all material respects the same as the above quoted provisions of the Revenue Act of 1934.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1950 995071 53

Supreme Court of the United States

OCTOBER TERM, 1950.

No. 98.

REPUBLIC STEEL CORPORATION, *Petitioner*,

v.

THE UNITED STATES OF AMERICA, *Respondent*.

REPLY BRIEF FOR PETITIONER.

Under argument 1 in respondent's brief (pp. 8-13) appea two separate contentions. Neither of them was a groun for the holding below.

The first contention of respondent is that the 117,00 common shares of Steel & Tubes No. 2 had a fair mark value, and represented an interest in the transferred pro erty, of $5,053,146.28, whereas the 117,000 preferred share of Steel & Tubes No. 2 had a fair market value of $10,228 846.15 and represented an interest in the transferred pro erty either in the amount of $10,228,846.15, as held belo (R. 57), or in the amount of $8,775,000.00, as contended f by petitioner (petitioner's brief, pp. 11-16), it being i material which, for either such amount is greater tha $5,053,146.28 and, therefore, exceeds a 50% interest (r

spondent's brief, pp. 10-12). That argument is unsound. It rests upon an assumption that $5,053,146.28 was the amount of the consideration for such common shares, was the fair market value of such common shares and represented the amount of petitioner's interest in the transferred property (respondent's brief, pp. 6, 11-12). That assumption is wholly without any support in, and is actually disproved by, the record herein.

The consideration for such common shares was not confined to the amounts totalling $5,053,146.28, as stated in respondent's brief, page 6. It also included petitioner's obligations to furnish to Steel & Tubes No. 2, inter alia, moneys and common stock in petitioner necessary to enable Steel & Tubes No. 2 to carry out its obligations under Section (G) of its Amended Articles of Incorporation relating to conversion and redemption rights attaching to its Class A and Class B preferred shares (R. 28-37).

Furthermore, the October 1, 1928 fair market value of the transferred property was not less than $19,556,992.43 (R. 41; respondent's brief, p. 6). It follows therefrom that if such preferred and such common shares of Steel & Tubes No. 2 represented a 100% interest in the transferred property, which is apparently conceded in respondent's brief, pages 10 and 12, then the interest in the transferred property, represented by such common shares, was greatly in excess of $5,053,146.28, as contended for in respondent's brief, pages 6, 11-12. In fact, the interest represented by such common shares was either $10,781,992.43 ($19,556,992.43 less $8,775,000.00) or was $9,328,146.28 ($19,556,992.43 less $10,228,846.15), depending upon whether the interest represented by such preferred shares was $8,775,000.00, as contended for in argument I in petitioner's previous brief, pages 11-16, or was $10,228,846.15, as was held below (R. 57).

The second contention of respondent is that, since all of the 117,000 preferred shares were issued to the transferor, since all of the 117,000 common shares were issued to peti-

tioner, and since there were no other shares issued, the transferor received 50% of the number of all shares issued and met the requirements of the applicable statute (respondent's brief, pp. 12-13). Both the terms of the statute referred to and the respective terms of the preferred and the common shares defeat such contention.

Under the statute, an interest or control in the transferred property of 50 per centum or more must have remained in order to render the statute applicable, not merely 50% of the number of the issued and outstanding shares irrespective of the terms thereof. Moreover, as demonstrated in argument I of petitioner's previous brief, pages 11-16, the terms of the preferred shares so differed from the terms of the common shares that the interest in the transferred property represented by the preferred shares did not exceed $75.00 per share, or a total of $8,775,000.00, whereas the interest represented by the common shares was all of the remainder of the value of the transferred property after deducting the $8,775,000.00, or a total of $10,781,992.43.

Petitioner denies that its argument assumes "that the interest in the property retained by the transferor is to be measured against the property transferred", as stated in respondent's brief, page 12, and that "there is no conflict in decisions", as stated in respondent's brief, page 13. In support of these denials petitioner respectfully refers to its argument presented, and the cases cited, in its previous brief, pages 11-21.

Respectfully submitted,

LUTHER DAY
THOMAS F. PATTON and
EARL W. LEFEVER
Counsel for Petitioner